Annual Report

THE KROGER GROCERY & BAKING COMPANY

FOR THE FISCAL YEAR 1944

Ending December 30, 1944

Annual Report of
The Kroger Grocery & Baking Company
FOR THE YEAR 1944

February 9, 1945

TO THE SHAREHOLDERS:

This report is for the year 1944 beginning January 2, 1944 and ending December 30, 1944 (52 weeks). Sales for the year (52 weeks) were $448,381,416, as compared with sales for 1943 (52 weeks) of $422,427,610, an increase of 6%. Net income (after provision for Federal taxes on income) for the year was $5,144,399, or $2.80 per common share, as compared with net income for the year 1943 of $5,009,228, or $2.72 per common share. The provision for Federal taxes on income for the year was $9,765,200 or $5.32 per share, as compared with $7,457,900, or $4.06 per share, for the previous year. Provision which is believed to be adequate has been made in the accounts for any repayment which may have to be made in the renegotiation of Government Contracts for the years 1943 and 1944.

In the conventional annual report the President usually comments on the past year's operating problems, the tribulations and achievements, and attempts to forecast future operations. This report is intended neither to recite heartaches nor to make prophecies, but rather to present a record of documentary facts.

We might whine about the burden of greatly increased Federal taxes, but in so doing we would ignore the fact that the war and related expenditures which made the taxes necessary have been at the same time instrumental to a great degree in helping us to achieve the largest volume of sales in our history, resulting in the second highest net income in fifteen years.

The rationing, pricing and enforcement policies of the O.P.A. have, at times, given us some mental suffering, as they may have you; but all of us would suffer more and longer without them. That agency is rendering an essential wartime service and is doing an especially creditable job in the control of food prices.

In view of the general events and happenings of the past two years, on the war and home fronts, it seems quite futile for us to attempt to predict the future or to comment on it in any satisfactory or helpful manner.

It is particularly difficult for us to make a long-period appraisal of business outlook because our industry is such a *fast-turnover industry.* Inventories, methods of distribution, personnel, and even policies, change rapidly. We must be ever alert to modify or revise our plans overnight, if need be, to meet and to keep up with the quickly changing problems of food procurement, consumer demand and distribution.

Plans for improved and enlarged operations in the postwar era are, of course, in the making. Our own Kroger Food Foundation is engaged in research on new products and new methods of distribution. Outside research counsel is also studying and experimenting for our benefit. But all of this must remain in the blue print stage until the time to utilize it arrives.

As we look forward together it may afford some satisfaction to stockholders to be reminded that Kroger has an unbroken record of having paid a dividend each year for forty-three years, and having earned every one of those dividends in the year in which it was paid. We are planning and we shall be trying to extend that unbroken record.

One great asset of your Company, not visible on the Balance Sheet, is the thousands of intelligent, efficient and loyal employees. The Company slogan, "If anybody can do it, *we can,*" has a real significance to them. Notwithstanding the gloom prevailing among many people, it is a fact that our employees enjoy a wholesome degree of optimism.

More than six thousand Kroger employees are now in the Armed Services. We have plans made for those who may come back, to reinstate them in their former jobs. In the interim, our training schools for those who have taken their places are accomplishing results which are astonishingly satisfactory.

Another Vice-President has been added to our staff in the person of Jacob E. Davis. He comes to us with a background of experience as an attorney, Judge, Member of the Ohio General Assembly, Representative to Congress, and, more recently, as a Special Assistant to the Secretary of the Navy and Assistant General Counsel for the Navy Department. His special duties at this time will be as head of our Legal, Legislative and Public Relations departments.

In last year's report you were informed of the anti-trust indictment returned against your Company. The District Court of the United States for the District of Kansas sustained a demurrer to this indictment. On appeal by the Government, the United States Circuit Court of Appeals for the Tenth Circuit reversed that decision. Upon rehearing, requested by your Company, the Circuit Court adhered to its former decision and remanded the case to the District Court for further proceedings. Then the United States Supreme Court refused our request for a review of the Circuit Court's ruling. The case is now pending in the District Court. The time for the trial has not been fixed; when it will be is not now known.

There is a matter that is real and tangible about which we want to tell you in a more detailed manner than is customary. It relates to the funds and the working tools, which are shown on the Balance Sheet and which you have entrusted to us to operate at a profit. The following comments are intended to answer questions that have been asked most often by stockholders and others. A review of the Balance Sheet items follows in the order in which they appear.

CASH AND DEPOSITS. We have plenty of money for our current needs. The total of Cash and Deposits is \$6,258,996 greater than one year ago. This represents funds in the tills of stores, in branch offices, and in transit, plus demand deposits in 1485 banks. There has been evolved a system by which we can measure the service rendered by these banks which enables us to maintain a satisfactory compensating balance with them. Our relations with our banks are most satisfactory to us and apparently so to them.

U. S. GOVERNMENT SECURITIES. It will be noted that the investment in these securities is equal to 73% of the Provision for Federal taxes. If so desired, proceeds from these securities may be used toward payment of Federal taxes.

The total of Cash and U. S. Securities, \$29,495,550, represents an increase of \$14,261,052 over one year ago.

NOTES AND ACCOUNTS RECEIVABLE. A substantial part of this is due from the United States Government for food supplies, while the remainder is due from vendors, large industrial accounts, and a few smaller accounts. Reserves have been provided which we believe are fully adequate for all possible losses.

INVENTORIES are valued at cost or market, whichever is lower. There is a decrease of \$7,960,112 (17%) from that of a year ago. We have no obsolete or excessive stock of merchandise. Considered on a tonnage basis, and in its relation to sales requirements, our number of days' supplies has been in recent periods, and is now, lower than we would normally carry. Nevertheless, we have been able to operate successfully on this lower ratio of supplies to sales. We may be obliged to change our program to meet a changed situation. As it appears today, the outlook for securing adequate merchandise to sell is more serious than it has ever been in any prior war year. That outlook might be changed for the better overnight, because we are in the midst of artificial controls, and the food requirements of the Armed Services and for Lend-Lease are ever changing and unpredictable.

SUPPLIES—PREPAID ITEMS. Supplies are primarily store wrapping materials and automotive repair parts. Prepaid items consist of rent, taxes, licenses, and unexpired insurance.

STOCKS AND BONDS. This is made up of a number of small items, scarcely requiring comment, but among them there is an item of \$19,750 representing the balance of outstanding claims for deposits in closed banks. This amount is fully covered by a reserve. There are, from time to time, inquiries concerning this item and there is some interest in having it reviewed now.

At the time of the so-called "National Bank Holiday" in March, 1933, the Company had deposits in 1,470 banks. Of this number 370 failed to reopen, thus tying up Company deposits in the amount of \$1,676,575. As already indicated, the uncollected balance today is \$19,750. We estimate that total write-offs of such deposits, heretofore made and to be made, will approximate only 6% of the original deposits impounded. Of this write-off 74% arose from 8 of the original 370 banks.

POST-WAR REFUND OF EXCESS PROFITS TAXES. The tax law provides for an excess profits tax credit recoverable either through post-war refund of excess profits tax or currently through reduction of permanent indebtedness. Through reduction of bank loans, we have taken credit currently and thus reduced the amounts of excess profits taxes by $1,685,000 for the years 1942, 1943 and 1944. Full credit was not obtainable currently so the balance of $132,400 remains as a post-war refund.

INVESTMENT IN SUBSIDIARY INSURANCE COMPANY. This item is fully explained in Balance Sheet, Note 1.

LAND. This is the property which underlies the various manufacturing plants and warehouses.

BUILDINGS. These consist of warehouses and manufacturing plants in various locations throughout the states in which we operate and some few store buildings. The majority of these plants would be rated modern in construction. The accrued depreciation on Buildings is 47%. It has been the policy of present management to lease warehouse properties as needed, rather than to build our own, and to discontinue the ownership of all store buildings. The total investment in store buildings is less than 1% of the total building asset. It is our policy to lease store rooms on the most liquid terms possible as neighborhood shopping centers do shift to quite an appreciable extent. We attempt to keep our lease liability at a low point. As a consequence 85% of our stores are on one-year leases with privilege of renewal.

Leasehold Improvements are no longer carried as an asset item in our Balance Sheet, which item prior to 1933 approximated 1½ million dollars. Improvements to leased store buildings are now charged as an expense against current operations.

Since a very large number of our stockholders purchased their shares subsequent to 1933, it seems now in order to explain to them the meaning and use of the following special language in the Balance Sheet, to-wit: "As appraised as at January 1, 1933 with subsequent additions at cost." In the year 1932 it became apparent to the management that the stated value of the Company's fixed assets needed revision. As a consequence, the Board authorized a reappraisal by outside appraisers, and, based on its findings of facts and conclusions, subsequently authorized the following items to be charged off in the years 1932 and 1933:

$3,200,000	as a reduction in value of land and buildings
1,568,700	as a reduction of leasehold improvements
1,736,290	as a reduction in value of equipment
$6,504,990	Total reduction in net book value

With this explanation it will be understood why our public auditors continue the use of this wording.

MACHINERY AND EQUIPMENT. The accrued depreciation of Machinery and Equipment is 66%. This item consists of machinery and equipment in manufacturing plants, warehouses, and stores, but does not include automotive or transportation equipment. This machinery and equipment is maintained in good condition and is adequate for our present requirements. When peace times come we will of course follow the policy of replacing old types with more efficient modern types.

AUTOMOTIVE EQUIPMENT. The accrued depreciation of Automotive Equipment is 86%. As quickly as supply conditions permit we shall replace some of this equipment at a cost of at least one million dollars. A high degree of efficiency in maintenance has enabled us to maintain adequate delivery. Replacement of truck tires is a major problem.

TOTAL BUILDINGS, MACHINERY, EQUIPMENT, AND AUTOMOTIVE, has an accrued depreciation of 63%, which we believe reflects a conservative, sound book value.

ACCOUNTS PAYABLE. This represents amounts payable for the purchase of merchandise, materials, and services. It is equivalent to less than two weeks of such purchases.

ACCRUED EXPENSES. This includes wages and rents payable, social security taxes, taxes withheld on employees' wages, sales taxes, real estate taxes, and personal property taxes.

PROVISION FOR FEDERAL TAXES. This is considered an adequate provision for Federal taxes for current and prior years.

NOTES PAYABLE. There was a reduction of $2,000,000 in this debt in 1944. This is a loan under a revolving bank credit wherein we may reduce the amount at any time, or reborrow at any time up to the original amount of $15,000,000. We pay a commitment commission of ½ of 1% on the unused portion. The net cost of the loan including commitment commissions (after Federal Income Tax) was 3/10 of 1% of funds used during the year 1944.

RESERVES. FOR CONTINGENCIES *and* FOR RISKS NOT COVERED BY INSURANCE. These are general reserves which may be used for many eventualities.

PREFERRED STOCK. This stock has no call provisions, but we reacquire it whenever possible.

COMMON STOCK. The number of shares outstanding was reduced by the retirement of 11,689 during the year. In the Balance Sheet of 1943 there was carried an item showing these shares being held for sale to officers and employees under stock option contracts. All such options having expired on October 2, 1944, and there being no further need for shares to be so held, the Directors authorized these shares to be retired. On March 4, 1931, the stockholders authorized that 100,000 shares be made available to employees, under stock option contracts, at $25 per share. The number of shares outstanding on that date was 1,813,486, and the number of shares outstanding at the date of this report is 1,836,589. This difference represents a net increase of 23,103, all of which were required to fulfill these stock option contracts. The net book value of Common Stock is $27.76 per share.

EARNED SURPLUS. This was increased by $1,464,977, and the total surplus now amounts to $9.42 per common share.

To the members of our Board of Directors, all of whom have given freely and continuously of their abilities and services in the solution of our many problems, and to our personnel, on whom the conduct of the business mainly depends, I extend my thanks and appreciation for their contributions to the progress of your company during the past year.

Respectfully submitted,

President.

CONSOLIDATED BALANCE S

ASSETS

Cash on hand and demand deposits			$21,493,494
United States Government securities, at cost (par value $8,000,000)			8,002,056
Notes and accounts receivable, less allowance for losses			3,681,311
Inventories of merchandise, at lower of cost or market			38,052,582
Store and general supplies			918,674
Prepaid insurance, rent and taxes			431,749
TOTAL CURRENT ASSETS			72,579,866
Stocks, bonds, mortgage notes, etc., less allowance for losses			110,679
Post-war refund of excess profits taxes (including bonds of $68,028)			132,400
Investment in subsidiary insurance company not consolidated, at cost (Note 1)			995,500
FIXED ASSETS:			
Land and buildings, as appraised as at January 1, 1933, with subsequent additions at cost:			
Land		$ 1,220,901	
Buildings	$10,193,626		
Machinery and equipment, as appraised as at January 1, 1933, with subsequent additions at cost	22,697,815		
Automotive equipment, etc., at cost	3,904,494		
	36,795,935		
Less, allowance for depreciation and obsolescence	23,190,977		
		13,604,958	14,825,859
Deferred charges to future operations			472,519
			$89,116,823

Note 1: The investment in Manufacturers and Merchants Indemnity Comp
the State of Ohio, represents the entire capital stock of that company other
in the net assets of the insurance company, determined in accordance wit
to $1,008,105. Total assets of the insurance company, so determined, amoun
and other marketable securities aggregating $1,356,216. Operations of th
dends were declared or paid by the insurance company during 1944.

HEET, DECEMBER 30, 1944

LIABILITIES			
Accounts payable			$ 9,999,256
Accrued expenses			3,944,601
Provision for Federal taxes, current and prior years			10,943,846
Dividends payable			11,261
TOTAL CURRENT LIABILITIES			24,898,964
Notes payable, banks; due October 15, 1946 (issued under loan agreement providing for payment at option of Company at any time prior thereto)			10,600,000
Reserves:			
For contingencies		$ 2,000,000	
For risks not covered by insurance policies		543,933	2,543,933
CAPITAL			
Preferred capital stock:			
First preferred, 6% par $100, authorized and issued 507 shares, less 3 shares in treasury, 504 shares outstanding	$ 50,400		
Second preferred, 7% par $100, 460 shares authorized and outstanding	46,000	96,400	
Common capital stock without par value:			
Authorized ... 3,000,000 shares			
Issued and outstanding ... 1,836,589 shares		$33,671,735	
Earned surplus, as annexed		17,305,791	51,073,926
			$89,116,823

pany, an insurance company licensed on November 29, 1943, under the laws of
than directors' qualifying shares. At December 31, 1944, the company's equity
the rules of the Commissioner of Insurance of the State of Ohio, amounted
ted to $1,363,535, consisting principally of cash, U. S. Government securities
e insurance company for the year 1944 resulted in a profit of $13,036. No divi-

Consolidated Statement of Income and Earned Surplus

FOR THE FISCAL YEAR (FIFTY-TWO WEEKS) ENDED DECEMBER 30, 1944

Net sales		$448,381,416
Cost of sales, including warehousing and transportation expenses, excluding depreciation		376,272,134
		72,109,282
Operating, general and administrative expenses, excluding depreciation		55,492,499
Profit from operations before depreciation, net income of subsidiary companies and provision for Federal income taxes		16,616,783
Depreciation		1,969,171
		14,647,612
Net income of subsidiary companies after depreciation of $34,031 and provision for Federal taxes on income of $303,200 (including $227,000 excess profits taxes less $22,700 post-war refunds)		180,189
		14,827,801
Interest paid, less interest and dividends received		221,402
Income before provision for Federal income taxes		14,606,399
Provision for Federal taxes on income (including $7,680,000 Federal excess profits tax, less $768,000 credit for debt retirement)		9,462,000
NET INCOME		5,144,399
Earned surplus, January 2, 1944		15,840,814
		20,985,213
Cash dividends paid in the fiscal year ended December 30, 1944:		
First preferred $6.00 per share	$ 3,024	
Second preferred $7.00 per share	3,220	
Common $2.00 per share	3,673,178	3,679,422
Earned surplus, December 30, 1944		17,305,791

TO THE BOARD OF DIRECTORS,
THE KROGER GROCERY & BAKING COMPANY,
CINCINNATI, OHIO.

We have examined the consolidated balance sheet of The Kroger Grocery & Baking Company and subsidiary companies as at December 30, 1944, and the consolidated statements of income and surplus for the fiscal year (fifty-two weeks) then ended, have reviewed the systems of internal control and the accounting procedures of the companies and, without making a detailed audit of the transactions, have examined or tested accounting records of the companies and other supporting evidence, by methods and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary.

In our opinion, the foregoing consolidated balance sheet and related consolidated statements of income and surplus present fairly the consolidated position of The Kroger Grocery & Baking Company and subsidiary companies at December 30, 1944, and the consolidated results of their operations for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fiscal year.

LYBRAND, ROSS BROS. & MONTGOMERY,
Certified Public Accountants

Cincinnati, Ohio
February 6, 1945.

FINANCIAL AND OPERATING STATISTICS

FOR THE FISCAL YEARS 1937 TO 1944, INCLUSIVE

	1937	1938	1939	1940	1941	1942	1943	1944
PROFIT AND DIVIDENDS								
Final Net Profit to Earned Surplus								
Dollars per Common Share	1.62	2.05	3.02	2.51	2.71	2.53	2.72	2.80
Total Dollars	2,950,340	3,741,569	5,514,597	4,607,126	4,970,102	4,649,484	5,009,228	5,144,399
Cash Dividends Paid—Dollars per Common Share	1.60	1.90	2.50	2.00	2.00	2.00	2.00	2.00
STOCK								
Number Shares Common Stock Outstanding with Public—End of Year	1,821,989	1,821,989	1,822,734	1,831,889	1,834,589	1,836,589	1,836,589	1,836,589
Number Shareholders — End of Year	26,226	25,983	25,202	25,681	26,173	26,479	26,827	27,194
SALES								
Total Sales—Dollars	248,444,230	231,295,622	243,356,605	258,115,025	302,765,745	388,847,338	422,427,610	448,381,416
Average Retail Sales—Dollars per Store per Week	1,122	1,091	1,177	1,278	1,594	2,148	2,566	2,821
STORES								
In Operation—End of Year	4,108	3,992	3,958	3,727	3,477	3,174	2,999	2,896
Average Number Operated During Year	4,169	4,032	3,943	3,846	3,601	3,348	3,062	2,943
EMPLOYEES								
Number Full-Time Employees—End of Year	21,515	20,498	21,691	22,358	22,784	18,567	18,289	18,425
BALANCE SHEET STATISTICS								
Current Ratio	4.63	4.49	4.27	3.76	3.92	3.17	3.38	2.91
Cash and U. S. Government Securities								
Dollars	12,123,820	14,889,287	13,032,957	11,507,754	17,963,435	19,495,954	15,234,498	29,495,550
Ratio to Current Liabilities	1.64	1.87	1.51	1.15	1.37	.92	.78	1.18
Inventories—Dollars	19,985,345	18,851,393	21,566,958	23,667,892	30,200,939	41,948,687	46,012,694	38,052,582
Fixed Assets—Percent of Total Assets	27	25	30	31	26	21	19	17
Net Working Capital—Dollars	26,878,892	27,801,102	28,227,897	27,615,402	38,168,582	45,746,364	46,646,782	47,680,902

THE KROGER GROCERY & BAKING CO.

Executive Offices: 35 East Seventh Street

CINCINNATI, OHIO

OFFICERS

CHARLES M. ROBERTSON, *President*

JOSEPH B. HALL, *Executive Vice-President and Treasurer*

JOSEPH BAPPERT, *Vice-President*

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Secretary and Ass't Treasurer

J. M. MARKLEY, *Assistant Secretary*

JACOB E. DAVIS, *Vice-President*

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R. B. CONANT, *Assistant Treasurer*

T. S. BURNS, *Assistant Secretary*

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President, The Mabley and Carew Co.

JOSEPH BAPPERT, *Cincinnati*
Vice-President and General Manager
Retail Division, The Kroger Grocery & Baking Company

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President, The Cincinnati Street Railway Company

CHARLES W. DUPUIS, *Cincinnati*
President, The Central Trust Company

HARRY J. GILLIGAN, *Cincinnati*
Proprietor, John J. Gilligan & Son

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Executive Vice-President and Treasurer
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Partner, Lehman Brothers

CARL M. JACOBS, *Cincinnati*
Partner, Frost & Jacobs

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Proprietor, Clovelly Stock Farm

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The Kroger Grocery & Baking Company

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The Shepard Elevator Co.

JOHN H. SADLER, *Cincinnati*
Secretary and Ass't Treasurer,
The Kroger Grocery & Baking Company

PUBLIC AUDITORS
Lybrand, Ross Bros. & Montgomery

GENERAL COUNSEL
Frost & Jacobs

TRANSFER AGENTS
The Provident Savings Bank and Trust Company, Cincinnati
Bankers Trust Company, New York

REGISTRARS
The Central Trust Company, Cincinnati
The Commercial National Bank and Trust Company of New York, New York